

New Language shown in underline

Section 25111 is amended to read:

§ 25111. Water's-Edge Election.

(a) General. This regulation shall be applicable to election contracts entered into for taxable years beginning on or after January 1, 1994 and before January 1, 2003. To the extent that a taxpayer would have been required to file on a water's-edge basis in its first taxable year beginning on or after January 1, 2003, pursuant to a water's-edge election made in a prior year under Revenue and Taxation Code section 25111 and this regulation, the terms of this regulation no longer apply and that election shall be deemed to have been made under the terms of Revenue and Taxation Code section 25113. However, the commencement date of the election made in a prior year under Revenue and Taxation Code section 25111 and this regulation shall continue to be treated as the commencement date of the water's-edge election period for purposes of applying the provisions of Revenue and Taxation Code section 25113.

(1) The election. In order to make the water's-edge election permitted by Revenue and Taxation Code section 25110, a taxpayer must enter into a contract with the Franchise Tax Board. The contract must be for an 84-month period.

(2) Validity of Election. The election contract shall be considered valid so long as there has been substantial performance of the requirements for entering into the contract.

(A) For purposes of this subsection "substantial performance" means that although there may have been noncompliance with one or more procedural or statutory requirements for making the election, the tax was computed consistent with a water's-edge election and there exists additional objective evidence to support the conclusion that an election was intended.

1. For purposes of this section objective evidence includes, but is not limited to:

a. One or more of the following substantially completed forms (or their successors) were attached to the original return: 100-WE, 1115, 1116, 2411, 2416, 2424, or 2426, or

b. Form 1117 request to terminate an election which sets forth the expiration date of the contract from which the first year of intended

election can be determined, was filed before January 1, 1997; or

c. A statement was attached to the original return indicating a water's-edge election was being made.

2. There may exist other evidence sufficient to support the conclusion that an election was intended, which may include checking a water's-edge box on the return.

(B) In the absence of a common parent election, whether or not there has been substantial performance of the procedural and statutory requirements for entering into a contract shall be determined with reference to the actions of the entire water's-edge group, as defined in subsection (b)(1). Substantial performance by every member of the water's-edge group shall constitute substantial performance by the entire water's-edge group. It is not necessary for every member of the group to substantially perform for an election to be valid.

(3) Termination.

(A) A taxpayer may request and the Franchise Tax Board shall terminate the election if the taxpayer is acquired by a larger nonelecting entity as described in subsection (i)(2)(A) of this regulation. The Franchise Tax Board may also in its discretion grant the taxpayer permission to terminate the election in other circumstances.

(B) For taxable years ending on or before January 31, 1997, if the water's-edge election of a corporation is affected by the amendments to this regulation effective October 31, 1998,

1. if prior to the effective date of such amendments the corporation was acquired by a non-electing, non-affiliated entity, and

2. if subsequent to the acquisition but prior to the effective date of such amendments, the acquired taxpayer filed its returns as if no water's-edge election were in place, the acquired taxpayer shall be deemed to have requested and been granted a termination of the water's-edge election as of the time of acquisition. Any termination resulting from the operation of this subsection (a)(3)(B) shall not be subject to the provisions of subsection (j) of this regulation.

(4) Ability to re-elect. The fact that a taxpayer has filed a notice of nonrenewal, or has terminated an election, or has been granted a change of election, shall not affect its ability to make an election subsequently.

(b) Definitions.

(1) Water's-edge group. Water's-edge group for purposes of Revenue and Taxation Code section 25111 means all corporations or other entities whose income and apportionment factors are considered pursuant to Revenue and Taxation Code section 25110 in computing the income of the individual taxpayer for the current taxable year which is derived from or attributable to sources within this state.

(2) Anniversary date. The anniversary date of the contract shall be the later of the original due date of the return or the due date of the return as extended. The anniversary date is established at the time the taxpayer enters into the contract and is on the same date for each subsequent year the election is in effect.

(c) Election by common parent. Election by the common parent of a controlled group which files a consolidated federal return pursuant to Internal Revenue Code section 1501, or the common parent wherever domiciled or organized, shall constitute an election by all members of the commonly controlled group which are part of the water's-edge group, notwithstanding any prior or subsequent filing by any member of the commonly controlled water's-edge group for the taxable year for which the election is being made (taking into account the provisions of subsection (g) of this regulation). The common parent may effect a common parent election whether or not the common parent is a taxpayer obligated to file a return in this state or will be a member of the water's-edge group for which the election is made. In such cases, the common parent election must be made on an original return filed by a member of the water's-edge group required to file under this part. Effective for taxable years beginning on or after January 1, 1995, a commonly controlled group is defined by Revenue and Taxation Code section 25105.

EXAMPLE: 1. Parent, a calendar year taxpayer, makes a common parent water's-edge election and includes Subsidiary A, also a calendar year taxpayer, as a member of the water's-edge group.

A. Parent, a California taxpayer, files a single group return on a combined basis for all members of the water's-edge group and includes the income and apportionment factors (both numerators and denominators) of A. A files a separate return and does not elect. A is deemed to have elected.

B. Parent, a California taxpayer, files its own return on a combined basis including the income and factors of A (denominators only) and other members of the water's-edge group. A files a separate return and does not elect. A is deemed to have elected.

C. Parent is not a California taxpayer but makes a common parent election which B, a member of the water's-edge group, includes with its return filed on a water's-edge basis. A files a separate return and does not elect. A is deemed to have elected.

D. Parent is not a California taxpayer. No common parent election has been filed by any California taxpayer which is a member of the water's-edge group prior to the due date (taking extensions into account) for filing a return. After the due date (taking extensions into account), a delinquent original California return is filed with a common parent election by a member of a commonly controlled group. Unless the corporation filing the return has a requirement to file a return with California and is a member of the water's-edge group, there is no valid election.

EXAMPLE 2. Same as 1 but Parent and A have different fiscal years. P's taxable year ends 3/31 and A's taxable year ends 12/31. P files its 3/31/98 taxable year return on 1/15/99 on a combined basis which includes A. A files its 12/31/98 return on 10/15/99 on a separate company basis and does not elect. A is deemed to have elected. A's and P's election begins 1/1/98 in accordance with the provisions of subsection (g) of this regulation.

(d) Election, those affected.

(1) In general. The contract, to be effective, must be entered into by all corporations required to file under this part which are part of the water's-edge group, or by the common parent electing in accordance with the provisions of subsection (c) of this regulation. A taxpayer or group of affiliated taxpayers, which is engaged in more than one unitary business, may make a water's-edge election with respect to one or more of the businesses, but it need not elect for all of its businesses.

EXAMPLE: Taxpayers A and B are members of an affiliated group which includes C, D, E and F, all incorporated in the United States, and G, H and I, all incorporated outside of the United States. G, H and I have no factors in the United States, are not eligible to be included in a federal consolidated return, and have no Subpart F income. A, C, D and G are engaged in one unitary business. B, E, F, H and I are engaged in a separate unitary business. Either A or B may elect to file on a water's-edge basis pursuant to Revenue and Taxation Code section 25110. It is not necessary for both A and B to make a water's-edge election.

(2) Changes in affiliation. Except as provided in Revenue and Taxation Code section 25111, subdivision (b), taxpayers will be bound by any valid contract they entered into, or are deemed to have entered into, for the entire term of the contract. Taxpayer will, for example, be bound by the election in the following situations:

(A) Subsequently taxable. A member of the water's-edge group which becomes subject to tax under this part subsequent to the election, or, subsequent to the election, is determined to have been subject to tax at the time of the election, shall be deemed to have elected.

(B) Subsequently determined to be a member of the water's-edge group. Except as provided in of Revenue and Taxation Code section 25111, subdivision (b), if an affiliated corporation which is a non-electing taxpayer is subsequently proved to be a member of the water's-edge group pursuant to a Franchise Tax Board audit determination, such affiliate shall be deemed to have made a water's-edge election effective as of the date of the election of the other members of the water's-edge group. A Franchise Tax Board audit determination shall be evidenced by the issuance of a notice of deficiency proposed to be assessed or a notice of tax change.

(C) Subsequently becoming a member of the water's-edge group. Except as provided in of Revenue and Taxation Code section 25111, subdivision (b), a corporation subject to tax under this part which becomes a member of an electing water's-edge group subsequent to an election having been made by the group shall be deemed to have elected, and shall be bound by, the election and the contract made by the group for the remaining term of the contract. In the event that such corporation becomes a member of an electing water's-edge group for part of a year, then such corporation shall be considered a water's-edge electing taxpayer only with respect to such part of a year and not for the entire year.

EXAMPLE: A elects to file its returns in accordance with Revenue and Taxation Code section 25110 for a period of 84 months beginning in 1994 and ending in 2000. B makes no election under Revenue and Taxation Code section 25110 and files its returns for years through 1997 pursuant to Revenue and Taxation Code section 25101. In 1998 A and B become engaged in a unitary business. For 1998 through 2000, B is deemed to have elected and shall be subject to the terms of A's election and contract.

(D) Reorganizations. Subject to the provisions of Revenue and Taxation Code section 25111, subdivision (b), a reorganization under sections of the Revenue and Taxation Code and Internal Revenue Code section 368 involving a water's-edge taxpayer will not cause a termination of the water's-edge election. In the case of an acquisitive reorganization, the water's-edge election is a tax attribute which will carry over to the acquiring corporation. Thus, for example, if a water's-edge taxpayer which is a party to a reorganization merges or liquidates into an acquiring corporation as a result of the reorganization, the water's-edge election will carry over and be binding upon the acquiring corporation. Each member of the acquiring group which is subject to tax under this part and which is, or subsequently becomes, unitary with the acquired water's-edge taxpayer or its successor shall be deemed to have elected and shall be bound by the acquired corporation's water's-edge election.

The carryover water's-edge election will not be binding on nonunitary activities of the acquiring corporation or its affiliates.

EXAMPLE: Corporation A, a calendar year taxpayer, elects to file its returns on a water's-edge basis for a period of 84 months beginning January 1, 1994. Corporation B, an unrelated calendar year taxpayer, has never made an election and files its California returns on a worldwide basis. On July 1, 1996, Corporation A is acquired by Corporation C, a unitary affiliate of Corporation B, in a statutory merger qualifying under Internal Revenue Code section 368(a)(1)(A). Corporation C was not itself a California taxpayer prior to acquiring Corporation A. The merged operations of former Corporation A became unitary with the pre-merger operations of surviving Corporation C, and therefore with Corporation B, effective January 1, 1997.

Corporation A's water's-edge election carries over to Corporation C. For the period July 1, 1996, through December 31, 1996, Corporation C will compute the taxable income attributable to the nonunitary merged activities of Corporation A on a water's-edge basis. Corporation B will compute its taxable income on a worldwide basis, including the pre-merger operations of surviving Corporation C, but not including the operations of Corporation C which were acquired by merger with Corporation A. (Since Corporation C was not a taxpayer prior to acquiring Corporation A, it does not have a California filing requirement with respect to the business operated by Corporation C before the merger.) Effective January 1, 1997, both Corporation B and Corporation C will be required to compute their income on a water's-edge basis.

(E) Liquidations. A water's-edge election is a tax attribute which will carry over and be binding upon the distributee(s) of property in a complete

liquidation of a water's-edge taxpayer to which Internal Revenue Code section 332 applies. However, for purposes of this subsection, the definition of "owner of stock" as set forth in of Internal Revenue Code section 332(b)(1) shall not apply. Rather, the owner of stock shall be defined as any corporation which is related to the liquidating corporation because of either of the following:

1. It owns directly or indirectly more than 50 percent of the voting stock of the liquidating corporation.
2. More than 50 percent of voting stock of both it and the liquidating corporation is owned or controlled directly or indirectly by any bank or person (as defined in Internal Revenue Code section 7701(a)(1)).

The carryover water's-edge election will not be binding on nonunitary activities of the distributee corporation(s) or its affiliates.

(F) Transfer to controlled entity. If an electing taxpayer transfers property to a corporation in a transaction to which Internal Revenue Code section 351 applies, the water's-edge election will be binding upon the transferee of the property. The carryover water's-edge election will not affect nonunitary activities of the transferee corporation.

(G) Subsequently disaffiliated. Except as provided in Revenue and Taxation Code section 25111, subdivision (b), where a corporation ceases to be a member of the water's-edge group, the election shall continue in force until the term has expired. A failure to file a notice of nonrenewal shall result in the renewal of the existing contract. For ability to terminate election, see subsection (i) of this regulation.

(e) Time of making the contract. The contract must be entered into at the time the original return for the year is filed and must be signed by an officer of the electing corporation. In the case of an election by the common parent of a controlled group, the contract must be signed by an officer of the common parent. For purposes of this section:

- (1) The original return is the last return filed on or before the due date (taking extensions into account) regardless of the form on which it is filed or however it may be denominated, or, if no return is filed by that date, the first return filed after such date. The contract may not be entered into through an amended return filed after the due date (taking extensions into account) of the original return.

(2) Timely filings which only supplement a previously filed return, or correct mathematical or other errors, shall be considered as incorporating the previously filed return, to the extent not inconsistent, and shall be treated as the original return for purposes of making a water's-edge election if they contain objective evidence of substantial performance as provided in subsection (a)(2) of this regulation. Any filing described in this subsection (e) of this regulation which clearly reflects an intent to withdraw an election made on previously filed return shall be treated as an original return.

EXAMPLE 1: T is a calendar year taxpayer which obtains a seven-month extension of time to file its return.

A. T files its original return on October 15 of the year. The contract shall be entered into on October 15.

B. T files its original return on May 15 of the year. The contract shall be treated as entered into on October 15.

C. T files a return on May 15 and files a second return on October 15. T's original return was filed on October 15. The election must be made by that time. If T's May 15th filing makes a water's-edge election, and the election is withdrawn in the October 15th filing, the election made on May 15th has no effect. If T's May 15th filing did not make a water's-edge election, and a water's-edge election is made on the October 15th filing, T has made a water's-edge election.

EXAMPLE 2. T, a calendar year taxpayer, files a return on February 15. T's return is treated as being filed on March 15, and March 15 is the date the contract is considered to have been entered into. Any return filed after March 15 (the due date of the return) will be considered an amended return.

EXAMPLE 3. T, a calendar year taxpayer, has a due date for its return of March 15. It files a return on February 15 and files a second return on March 10. The return filed on March 10 is treated as the original return for the year. The election to file on a water's-edge basis must be made on the March 10 filing to be effective. If T's February 15 filing makes a water's-edge election and the March 10 filing does not make an election, the election made on the February 15 return has no effect. If T's February 15th filing did not make a water's-edge election, and a water's-edge election is made on the March 10th filing, T has made a water's-edge election.

(f) Length of contract. At the time the contract is entered into, the taxpayer must agree to file on a water's-edge basis for an 84-month period. If a change in accounting periods is made which results in a short period tax year, it shall not shorten the period covered by the contract.

(g) Effect of different fiscal years. In the case of taxpayers which are on different fiscal years, each member of the water's-edge group shall make the election upon its original return for the taxable year for which the election is being made. The election shall become effective as of the beginning of the taxable year of the last member of the water's-edge group to file its return and election. The 84-month election period for each member of the water's-edge group will run from the date that the election becomes effective, i.e., the beginning of the taxable year of the last member of the water's-edge group to elect.

Each taxpayer in the group shall calculate its tax on a worldwide basis for that portion of the year between the beginning of its taxable year and the beginning of the taxable year of the last member of the group to make the election, and on a water's-edge basis for the remainder of the taxable year.

EXAMPLE: Corporation A and Corporation B are California taxpayers engaged in a unitary business and wish to make a water's-edge election. Corporation A's taxable year ends December 31 and Corporation B's taxable year ends March 31. A files an election for its taxable year ended December 31, 1994, on its return filed on October 15, 1995. B files an election for its taxable year ended March 31, 1995, on its return filed on January 15, 1996.

Corporation A's 84-month election period begins April 1, 1994, the beginning of the taxable year of the last member of the group to elect. Corporation A will file its return for the taxable year ending December 31, 1994, apportioning its income to California on a worldwide basis for the period from January 1, 1994, through March 31, 1994, and on a water's-edge basis for the period from April 1, 1994, through December 31, 1994. Corporation B will file its return for the taxable year ending March 31, 1995, apportioning its income to California on a water's-edge basis for its entire taxable year.

(h) Renewal.

(1) Automatic. Once a contract is entered into, it shall automatically renew on its anniversary date unless a notice of nonrenewal is filed with the Franchise Tax Board. Such renewal shall extend the 84-month period of the contract for an additional 12 months. Except as provided in Revenue and Taxation Code section 25111.1, a contract shall always be in effect 84 months from the beginning of the taxable year covered by the most recent anniversary date absent a notice of nonrenewal.

EXAMPLE: T, a calendar year taxpayer, makes a water's-edge election and enters into an 84-month contract with its return filed March 15, 1995. The contract covers

the taxable years 1994 through 2000. No timely notice of nonrenewal is received prior to the time T files its return for the taxable year 1995 on March 15, 1996. The contract is automatically renewed and extends the election through the taxable year 2001.

(2) Notice of nonrenewal.

(A) In general. A taxpayer may file a notice of nonrenewal at any time within the contract period. A taxpayer may file a notice of nonrenewal at the same time it makes the election. In order to be effective to terminate the automatic renewal provisions, the notice must be delivered to the Franchise Tax Board at least 90 days prior to the anniversary date. Delivery may be made in person or by mail. In the case of a mailed notice, the date of the postmark shall constitute the date of delivery. For a notice of nonrenewal to be effective, it must be entered into or be consented to by all taxpayers which are members of the water's-edge group. A notice of nonrenewal may be filed by the common parent of a controlled group for all California taxpayers.

If a member of the water's-edge group is deemed to have made an election pursuant to the provisions of subsection (d)(2)(A) or (B) of this regulation, such member shall also be deemed to have entered into any notice of nonrenewal filed by the other members of the water's-edge group.

EXAMPLE 1: T, a calendar year taxpayer, makes a water's-edge election and enters into an 84-month contract with its return filed March 15, 1995.

A. T files a notice of nonrenewal on March 15, 1995. The contract shall be in effect for the taxable years 1994 through 2000. For taxable years 2001 and thereafter, T shall file under Revenue and Taxation Code section 25101, unless a new contract is entered into prior to or with the return filed for the taxable year 2001.

B. T files a notice of nonrenewal on February 15, 1996. The original contract was in effect for the taxable years 1994 through 2000. T's notice of nonrenewal is not timely to prevent the automatic renewal as of March 15, 1996. The contract shall be extended for one year and shall include the taxable year 2001. The notice of nonrenewal shall be effective for taxable years 2002 and thereafter.

EXAMPLE 2. T, a calendar year taxpayer, makes a water's-edge election and

enters into an 84-month contract with its return filed May 15, 1995. T had an extension to file its return until October 15, 1995. T files a notice of nonrenewal on July 1, 1996. Since the notice of nonrenewal was filed at least 90 days prior to the anniversary date of October 15, 1996, the contract shall be in effect for taxable years 1994 through 2000.

(B) Effect on election. Serving a notice of nonrenewal shall not terminate the taxpayer's obligation to file pursuant to Revenue and Taxation Code section 25110 until the 84-month period has expired.

(i) Termination of election.

(1) In general. A taxpayer may terminate the election if:

(A) it is acquired directly or indirectly by an unaffiliated non-electing entity which, with those of its affiliates which are included in its combined report, is larger in terms of equity capital than is the taxpayer,

(B) the Franchise Tax Board grants permission.

(2) Acquisition by larger entity.

(A) In general. A taxpayer which is acquired by a larger, unaffiliated entity may request, and the Franchise Tax Board shall allow, the termination of an election effective for the taxable year immediately succeeding the taxable year in which it is acquired, directly or indirectly, by a larger entity. The request must be made no later than the due date of the return (including extensions) for taxable year immediately succeeding the year of acquisition.

(B) For purposes of Revenue and Taxation Code section 25111, subdivision (b)(1), "taxpayer" means the individual corporation with a requirement to file under this part. It does not mean the water's-edge group or all the members of the water's-edge group which are required to file under this part.

(C) Acquisition. A taxpayer is acquired if it, or any entity or entities which own a majority of its voting stock, has a quantity of its voting stock purchased by another entity sufficient to give such entity control of over 50 percent of such stock sufficient so that it may control the affairs of the purchased entity.

(D) The relative size of the taxpayer and the acquiring entity shall be determined by a comparison of their equity capital. For purposes of this provision equity capital includes issued stock of any class, paid in capital, and retained earnings or earned surplus, as set forth on the balance sheet of such entity for the immediately preceding year-end accounting period.

(3) Request for termination of election.

(A) In general. A taxpayer may request permission of the Franchise Tax Board to terminate its election pursuant to Revenue and Taxation Code section 25111, subdivision (b)(2), at any time.

(B) Conditions for granting. The request shall be granted only if the taxpayer demonstrates to the satisfaction of the Board that the requirement to file returns under Revenue and Taxation Code section 25110 rather than under Revenue and Taxation Code section 25101 for the unexpired term of the contract shall result in a significant disadvantage to the taxpayer, and that such disadvantage is the consequence of an extraordinary and significant event which could not have been reasonably anticipated at the time the original election was made.

1. Extraordinary and significant event. For purposes of this subsection an extraordinary and significant event includes but is not limited to:

a. Changes in ownership or affiliation. The acquisition of the taxpayer directly or indirectly by a new owner, the acquisition by the taxpayer or its affiliates of new subsidiaries, or a reorganization or sale or other action resulting in a disaffiliation of the taxpayer from some or all of its affiliates. Changes in ownership or affiliation undertaken for tax avoidance purposes or for purposes of avoiding the water's-edge contract do not constitute an extraordinary or significant event. A request for termination of election made by reason of a change in ownership or affiliation must be made no later than the due date (including extensions) of the return for the taxable year immediately succeeding the taxable year in which the change in ownership or affiliation occurred.

2. Significant disadvantage. A significant disadvantage includes but is not limited to a material difference, which is unfavorable to the taxpayer, between California tax liabilities, computed pursuant to Revenue and Taxation Code sections 25110 and 25101 over the remaining life of the election. Such material difference must be shown in respect of the aggregate tax liabilities of all members of the water's-edge group subject to tax in California. Such

material difference must be demonstrated by reasonable estimates which take into account all currently and readily available pertinent information. The taxpayer must demonstrate that the significant disadvantage is the result of the particular extraordinary and significant event giving rise to the request.

(4) Effective date. Except as otherwise provided, any request granted by the Franchise Tax Board pursuant to subsection (i)(3) of this regulation shall be effective for the taxable year immediately succeeding the taxable year in which the qualifying event occurred. If requested by the taxpayer, the Franchise Tax Board may grant the request effective for some later taxable year. Requests may not be retroactive.

(5) Form and procedures.

(A) Form. A request to terminate an election must be made in writing and it must include a statement of the reason for the request. The request must be mailed to the Franchise Tax Board under separate cover. Requests included in a tax return or enclosed with other correspondence not related to the request to terminate will not constitute adequate notification of a request to terminate the election and will be treated as if not filed.

1. A request made pursuant to Revenue and Taxation Code section 25111, subdivision (b)(1), must include a statement of the facts which demonstrate that the conditions of subsection (i)(2) of this regulation have been satisfied.

2. A request made pursuant to Revenue and Taxation Code section 25111, subdivision (b)(2), must include a statement as to why the requirements of subsection (i)(3)(B) of this regulation are satisfied. It must include an accounting of the gains and losses described in subsections (j)(4) and (5) of this regulation.

(B) Withdrawal. The taxpayer may withdraw its request at any time prior to the Franchise Tax Board's granting permission.

(C) Franchise Tax Board review. In considering a request, the Franchise Tax Board may examine books and records with respect to gains and losses covered by subsections (j)(4) and (5) of this regulation, earnings and profits of affiliated corporations, the nature of the event giving rise to the request, the consequences of such event, and such other relevant matters.

(D) Time of action. Within 90 days of receipt of a request to terminate the election, the Franchise Tax Board shall either act on such request or advise the taxpayer what additional information is needed to consider the request. Following receipt of all such additional information, the Franchise Tax Board shall act on the request within 90 days.

1. If in the case of a request pursuant to Revenue and Taxation Code section 25111, subdivisions (b)(2), the Franchise Tax Board takes no action or requests no additional information, the request is deemed disallowed on the expiration of the 90 days. The taxpayer may grant the Franchise Tax Board additional time to consider the request.

2. If in the case of a request pursuant to Revenue and Taxation Code section 25111, subdivision (b)(1), the Franchise Tax Board takes no action or requests no additional information, the taxpayer shall be deemed to have met the requirements for termination on the expiration of the 90 days.

(j) Conditions of termination of election. If the Franchise Tax Board grants a request to terminate an election pursuant to Revenue and Taxation Code section 25111, subdivision (b)(2), the following conditions shall be imposed as necessary to prevent the avoidance of tax or clearly reflect income for the period the election was, or was purported to be, in effect.

(1) Dividends. Dividends received during the remaining period of the contract from affiliated corporations not described in Revenue and Taxation Code section 25110 shall be considered to have been paid first out of earnings and profits not included in a combined report of a unitary business for purposes of Revenue and Taxation Code section 25106. To the extent dividends exceed such earnings and profits, they may be considered to be subject to Revenue and Taxation Code section 25106.

(2) Gains. Gain on distribution with respect to stock which are not dividends or from the sale or other disposition of assets received during the remaining period of the contract from affiliated corporations not described in Revenue and Taxation Code section 25110 shall not be deferred or eliminated.

(3) Losses. Loss from the sale or worthlessness of stock or from the sale or other disposition of assets of an affiliated corporation not described in Revenue and Taxation Code section 25110 during the remaining period of the contract shall be allowed only to the extent of income or gain recognized by reason of subsections (j)(1) or (j)(2) of this regulation unless such loss would have been recognized on the return filed under Revenue and Taxation Code section 25110.

(4) Gain on water's-edge affiliates. Gain on the disposition of stock of an affiliated corporation which was included in a combined report prior to the election under Revenue and Taxation Code section 25110, or on the disposition of assets of such affiliate, and which was excluded from the combined report by reason of Revenue and Taxation Code section 25110, shall be included in income in the first return filed after the termination of the election.

(5) Losses on water's-edge affiliates. Loss on the disposition of stock of an affiliated corporation which was included in a combined report prior to the election under Revenue and Taxation Code section 25110, or on the disposition of assets of such affiliate, and which was excluded from the combined report by reason of Revenue and Taxation Code section 25110, shall be included in income in the first return filed after permission is granted to the extent that gain is included under subsection (j)(4) of this regulation.

Note: Authority cited: Section 19503, Revenue and Taxation Code.
Reference: Section 25111, Revenue and Taxation Code.